



*Il Ministro dell'Economia
e delle Finanze
Prot. 986/Min.*

Rome, 27 October 2014

Dear Vice President, Dear Jyrki

Thank you for your letter of October 22nd with your preliminary assessment on Italy's fiscal effort.

On your suggestion to increase the budget correction for 2015 to ensure full compliance with Italy's budgetary obligations under the SGP, let me inform you that, after further discussions at the political and technical level with the Commission, the Italian Government is committed to adopt additional measures for 2015 in order to strengthen the fiscal effort already envisaged in Italy's Draft Budgetary Plan (DBP).

These measures include:

1. an allocation to deficit reduction of the Fund originally set for lowering the tax burden (3.3 billion);
2. a reduction of the share of domestic resources allocated to the co-financing of EU cohesion funds and exempted from the ceilings of the domestic stability pact applying to Regions (0.5 billion);
3. an extension of the reverse-charge regime to the retail sector (0.73 billion), supported by a surcharge on excise taxes as a safeguard clause. The measure, which aims at curbing tax evasion, needs the approval of the EU institutions.

This package of measures will bring the structural adjustment to over 0.3 percentage points of GDP in 2015, improving the path towards the medium term budgetary objective (MTO).

At the same time, it is my duty to remind you that the Italian economy is going through one of the most severe and lengthy recessions in its history. GDP declined by more than 9% with respect to the level of 2008. The economy is now in its third year of recession and at serious risk of deflation – or a prolonged period of very low inflation - and stagnation. A fourth year of recession is to be avoided by all means as it would be extremely problematic to pull the country out of such an economic environment. Furthermore, it would make debt sustainability much harder to be maintained.

Hence, the Italian Government has proposed a mix of measures aimed at minimizing these macroeconomic risks, since a tighter fiscal stance and/or a radically different composition would be too risky and possibly self-defeating in terms of debt dynamics.

Mr. Jyrki Katainen
Vice-President and European Commissioner
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The Government aims at implementing a growth-friendly fiscal adjustment based on a durable improvement related to enhanced efficiency and quality of public expenditure at all levels of government and permanent cuts in the tax burden on labour. Growth-enhancing spending such as R&D, innovation, education and essential infrastructure projects is increased. The budget composition will support the structural reform process which will continue with further adjustments in the labour market and the civil justice system expected to be delivered by early next year. The Government aims at ensuring that the general government debt is on a sufficiently downward path, also thanks to an ambitious privatization plan for an amount of 0.7% of GDP per year on average. Some delays, due *inter alia* to adverse market conditions, will be caught up in the incoming months in order to fully achieve the programmed effects on the debt by 2015.

Moreover, as you pointed out in your letter, Italy's budgetary strategy is to be considered within the overall agenda for structural reforms. It is exactly for that reason that the Italian Government has decided to make use of the flexibility granted by the European (Article 5 of Regulation 1466/97) and national legislation (Article 3, Paragraph 4 of Law No. 243/2012) in order to implement an ambitious package of structural reforms aimed at enhancing potential growth. These reforms will have a direct impact on potential growth and debt sustainability, thus allowing, in accordance with European and national laws and regulations, a temporary deviation from the convergence path towards the MTO.

Let me also remind you that Italy's output gap is expected to remain extremely large by historical standards in 2014 and will not decrease with respect to its "representative" level in 2015. This is the reason why the Italian Government had decided (in line with provisions of Article 5 of European Regulation No. 1466/97 and Article 6 Paragraph 6 of Law 243/2012 of national legislation) to postpone the achievement of the MTO to 2017, in order to deal with such unusual tightening in economic conditions, which at least for 2014 and 2015 have to be regarded as exceptional circumstances.

However, despite these adverse economic conditions, the extra budgetary measures I am putting forward in my letter will allow Italy to improve the adjustment towards the MTO, to get closer to the required structural effort and to ensure closer adherence to the transition debt rule.

Finally, I would like to thank you for the constructive dialogue during the past few days and I trust these extra measures will fully address the concerns expressed in your letter and lead to full compliance with budgetary requirements. I also trust that the Commission will fully take into account, in its forthcoming Opinion, the revised Draft Budgetary Plan we will prepare over the next few days. To that purpose, I suggest that our services continue to stay in close contact and share additional information.

Yours sincerely,



Pier Carlo Padoan